

This letter discusses sales tax issues of concern to a business that provides both traditional and virtual file room services. See 86 Ill. Adm. Code 130.101. (This is a GIL.)

June 25, 2007

Dear Xxxxx:

This letter is in response to your letter dated July 7, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

ABC, an industry leader in the administration of patient charts, provides traditional and virtual file room solutions. We are in the process of compiling and updating information regarding the taxability of our sales and service. Below are the different types of revenue that ABC generates:

Product #1: Release of Information:

We contract directly with hospitals to perform services related to the search, retrieval, copying, and delivering of medical records for requesting parties, which may include, but are not limited to, hospitals, doctors, insurance companies, attorneys, governmental agencies, and individuals. Our company places a copy machine or scanner at each hospital for our use. On predetermined days, company personnel report to the hospital to search for, retrieve, and copy the requested and charts. The copies are then delivered (generally, sold), along with an invoice, to the requesting party.

Included on the invoices are the charges for the search/retrieval, the actual medical record copies, and shipping (paid to a common carrier or the US post office).

Product #2: Disclosure Reporting

ABC Disclosure Reporting Service uses proprietary chart tracking software to collect all the information that organizations need to meet the disclosure reporting requirements specified by HIPPA (Health Insurance Portability and Accountability Act). ABC's hospital

customers can then use the software to generate a report that delivers the information either to our hospital customer or to the requestor (a patient of the hospital). Monthly software subscription usage fees are based on the size of hospital.

Product #3: Recurring ROI Services and File Management Services

ABC provides staffing to support hospitals and clinics with their medical records management. In return, we charge our customers an hourly rate for the work performed. Generally, these employees are hired to manage specific hospital projects under the direction of ABC personnel. However, there may be occasions where these employees operate under the direction of hospital (our customer) personnel.

Product #4: Storage

ABC rents a storage space outside of hospitals & clinics to store all medical records and we charge our customers a monthly storage fee based on size and volume of their records. The hospitals then use these records in their business (they are not held for re-sale [sic]).

Product #5: Coding

ABC provides coding services to hospitals and clinics to help with backlog of charts that need to be coded for billing. Charges are generally based on a charge per medical record chart that is coded, but also could be charged using a per hour rate.

Product #6: Scanning

ABC provides scanning service on site or at one of our scanning facilities. We charge a per image based service fee.

Product #7: Virtual File Room

ABC digitally captures all the patient records into an electronic chart management system. The records are then available and accessed by the hospital or clinic over the internet while ABC hosts and maintains the application in another location (usually out of state). The hospital accesses this electronic file room and the charts located therein on a daily basis for a variety of reasons, including but not limited to, patient care, chart signature and completion, chart processing, collection of fees related to services rendered, and requests by health care peer review organizations. The charges include monthly software subscription hosting and usage fee and a one-time implementation fee is charged.

We would appreciate the following information for each of the services/products referenced above:

1. Are they taxable?
 - a. For Release of Information service, if the service transaction is taxable,
 - Is the actual postage taxable?
 - Is the handling taxable?
 - b. For the Release of Information service, if the service transaction is not taxable, are the paper costs incurred to generate revenue taxable?

2. For Release of Information service, if the requesting party is located outside your state, but the request is fulfilled from a location within the state and delivered to the requesting party outside your state, is the transaction taxable?

Please provide a letter and a copy of the rules and regulations as they relate to the photocopying of medical records and our other lines of product. It will be highly appreciated if you could send your response to the following address:

ABC/address

Thank you in advance for your assistance. Please do not hesitate to call me for further information on the nature of our business.

DEPARTMENT'S RESPONSE

Your request has been forwarded to the Sales and Excise Division of Legal Services. This response is in regard to sales tax issues, only.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 86 Ill. Adm. Code 150.101. If no tangible personal property is being transferred to the customers, then neither Illinois Retailers' Occupation Tax nor Use Tax would apply. Likewise, the Service Occupation Tax Act and Service Use Tax are imposed on the transfer of tangible personal property incident to sales of service. See 86 Ill. Adm. Code 140.101 and 160.101. If no tangible personal property is being transferred to the customers incident to the services provided then no Illinois Service Occupation Tax nor Service Use Tax would apply.

Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on the cost price if they are registered de minimis servicemen; or, (4) Use Tax on the cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts

production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen do not have the option of determining whether they are de minimis using a transaction-by-transaction basis. See 86 Ill. Adm. Code 140.109.

Tangible personal property that is transferred incident to document retrieval services, such as the providing of copies of documents, could fall below the de minimis threshold. If this is the case, it would allow such servicemen to determine its tax base in any of the above methods. Historically, most service providers that qualify as de minimis and are not otherwise required to register with the Department prefer to determine their tax base under the last method. Generally, processing charges, photocopy charges, document retrieval charges, and other such charges are considered sales of service, which are encompassed in the above discussion.

For information regarding the Department's regulation on the treatment of transportation and delivery charges under the Retailers' Occupation Tax Act please see 86 Ill. Adm. Code 130.415. Transportation and delivery charges, also designated as shipping and handling charges, are not taxable if it can be shown that the charges are agreed to separately from the selling price of the tangible personal property sold and the charges are actually reflective of the costs of shipping. To the extent the transportation and delivery charges exceed the costs of shipping, the charges will be subject to tax.

As noted in subsection (d) of Section 130.415, if the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his Retailers' Occupation Tax liability.

The best evidence that transportation or delivery charges were agreed to separately and apart from the selling price is a separate and distinct contract for transportation or delivery. However, documentation which demonstrates that the purchaser had the option of taking delivery of the property, at the seller's location, for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice.

In regard to the Disclosure Reporting program, we are not sure what the specific arrangement is in regards to the monthly software subscription fees. However, we hope the following information will be helpful.

Generally, sales of “canned” computer software are taxable retail sales in Illinois. Sales of canned software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of 86 Ill. Adm. Code 130.1935. Custom computer programs or software must be prepared to the special order of the customer.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the entire agreements would be taxable as sales of canned software.

Storage fees charged customers are not subject to sales tax liability unless tangible personal property has been sold at retail or transferred incident to a service provided. This would be the same for coding services and scanning services as long as no tangible personal property is transferred incident to the providing of that service.

No tax is incurred on sales in which the seller is obligated, under the terms of his or her agreement with the purchaser, to make physical delivery of the goods from a point in this State to a point outside this State, not to be returned to a point within this State, provided that the delivery is actually made. See 86 Ill. Adm. Code 130.605(c), “Sales of Property Originating in Illinois.”

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
Associate Counsel

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